**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

**IN THE MATTER OF THE APPLICATION OF
MIDWEST ENERGY, INC. FOR APPROVAL TO
MAKE CERTAIN CHANGES IN ITS
CHARGES FOR GAS SERVICE**

DOCKET NO. 06-MDWG- 1027 -RTS

DIRECT TESTIMONY OF

**EARNEST A. LEHMAN
PRESIDENT AND GENERAL MANAGER**

MIDWEST ENERGY, INC.

DIRECT TESTIMONY OF EARNEST A. LEHMAN

Q: Please state your name, position and business qualifications.

A: My name is Earnest A. Lehman, President and General Manager of Midwest Energy, Inc. (Midwest Energy). I have been employed by Midwest Energy since 2003, first as Chief Operating Officer, and since the beginning of 2004 as President and General Manager. I have been a regulator or employee of natural gas and electric utilities since 1976. I worked for more than 18 years in regulatory, corporate development and marketing management positions with the company now known as Westar and its predecessors, followed by several years running an energy services division/subsidiary of El Paso Electric Company in Texas. My earliest utility experience was gained as an Economist at the Federal Energy Regulatory Commission. I have a B.A. in Economics with Distinction from the University of Wisconsin-Madison and an MBA in Finance and Analysis from The George Washington University. I testified before the Commission many times during my years with Westar. This is my first appearance on behalf of Midwest Energy.

Q: What is the purpose of your testimony?

A: I will provide an overview of the proposed delivery rate increases, the cost and other drivers that necessitate this filing, and the impact of this filing on our customer-owners. I conclude my testimony by explaining how the ownership of Midwest Energy by its customers has driven and is reflected in this filing to increase their gas delivery rates.

Q: What is the magnitude of the revenue increase proposed by Midwest Energy?

A: Based on a 2005 proforma test year, Midwest Energy proposes to increase revenues for delivery service by $3,420,000. The revenue requirement is detailed and supported by the testimony of Tom Meis, with support for the cost of member-provided equity given by the testimony of William K. Edwards of the National Rural Utilities Cooperative Finance Corporation (CFC).

Q: What is the impact of the proposed increase on customer bills?

A: Using the 2005 proforma test year, average bills increase by 6.7%. The rate design and spread of the increase is detailed and supported by the testimony of Michael Volker.

Q: How do Midwest Energy's current gas delivery rates compare with those charged by other Kansas Local Distribution Companies (LDC's)?

A: Despite our service territory's low population density, low to negative population growth and challenging economic conditions, most of our customers pay lower delivery rates than their counterparts pay other Kansas LDC's serving more densely populated and growing areas.

Q: How much of an average Midwest Energy customer's bill is determined by delivery rates?

A: With the large increases in wholesale gas costs in recent years, delivery charges now account for roughly 27% of the bill. This is the only portion of the bill that is retained by Midwest Energy. The rest is passed along to our gas suppliers and other pipelines that bring the gas to our system.

Q: How big are the proposed increases in comparison to Midwest Energy's current gas delivery rates?

A: The increase in delivery rates averages 25%. Differences by class of customer are addressed by Michael Volker in his testimony and exhibits.

Q: Why does Midwest Energy need these rate increases?

A: These rate increases are needed to offset increasing costs of construction, operation and maintenance and to maintain the integrity of an aging gas distribution network experiencing declines in the total number of meters, average usage per meter and throughput.

Q: Can you identify some of these increasing costs?

A: Yes. We've compared the current costs for some common elements of gas plant with the costs we paid back in 2001, the test year for our last gas delivery rate increase. In 2001, 2-inch diameter polyethylene pipe cost $0.71 per foot. Now we pay $1.12, a 58% increase. Our most commonly used steel pipe, also having a 2-inch diameter, has increased from $1.68 per foot to $3.02, an 80% increase. Residential risers, regulators and stop cocks have risen 39% to 72%. Meters and reliefs have risen a more reasonable 10%.

Q: Why do you characterize Midwest Energy's gas distribution system as "aging"?

A: One need only refer to Midwest Energy's filing of the 2005 Annual Report for Gas Distribution System # F 7100.1-1. This report includes statistics on the vintage of our gas mains. Approximately 17% of our mains were installed in 1949 or before. Almost 60% of mains are at least 35 years old.

Q: How has the number of gas meters changed since the 2001 test year?

A: The number of gas meters we serve has declined from 42,933 in the 2001 test period of our last rate case to 41,645 meters in our 2005 test period. This is a 3% decline. The drops have been particularly severe with respect to gas irrigation and oil field pumping. The number of gas irrigation meters exclusive of the Finney County project has dropped by 728 (22.3%) to the current level of 2,531 meters. Oil field pumping is now provided by 198 gas meters, 45.5% less than the number included in our last rate case.

Q: Why do you conclude that average usage is declining?

A: History proves it. At a recent meeting of the Midwest Energy Association (an industry organization), I learned that Local Distribution Companies (LDC's) across the country are seeing long-term declines of roughly 1% per year in average usage per residential customer. For Midwest Energy, I reviewed the weather-normalized average usage from our 2001 test year and compared it to that used in the 2005 test year for this rate case. Average residential customer usage has declined from 85 mmbtus/year in 2001 to 79 mmbtus/year in 2005. I also looked at raw, actual, non-adjusted data. Taking a longer view, a Midwest Energy residential customer's average usage has declined by 12.6% since 1999, a 2.2% compound annual rate of decline.

Q: Won't rate increases cause further declines in usage?

A: Customers will respond to higher prices with some decline in usage, but such declines will certainly be less than those induced by the soaring cost of natural gas itself in recent years. On average, our proposed delivery rates are 43 cents per decatherm higher than current rates. But natural gas commodity and transportation costs in 2005 averaged $2.19 per decatherm higher than in 2004, and are $2.39 higher than the levels reflected in the 2001 test year used in our last natural gas rate case. Put plainly, our gas suppliers and the pipelines we use have collectively increased costs to customers more than 5 times as much as our proposed increase.

Q: How has throughput declined in recent years?

A: Section 8, Schedule 6, line 10 (Total Unit Sales) paints a clear picture. Total deliveries for natural gas customers have declined every year from 2002 through 2005. The decline was no less than 3.3% in any one year, and 2005 Total Unit Sales are 22.8% below 2002.

Q: Is Midwest Energy's LDC business caught in a cycle of higher and higher rates?

A: Certainly we see continued cost pressure in the years ahead. And certain loads like gas irrigation and oil field pumping are likely to erode further. Also many of the areas where we operate as an LDC have declining populations. Unfortunately, we can't abandon pipe and reduce costs proportional to declines in the number of customers or throughput. But we believe customers need and can pay for a viable gas distribution network in most of the areas we currently serve for many years into the future. While we believe gas prices will remain high, we do not expect year after year of the sharp price increases we have seen recently. The days of $3 gas are probably gone forever, but we don't see $20 gas in the picture either. We do see a likelihood of further rate increases, with such increases needed sooner if Mr. Volker's proposed Normalized Volume Rider is not adopted in this proceeding.

Q: Why is the ownership of Midwest Energy by its customers an important factor in this proceeding?

A: Mr. Edwards addresses the meaning and impact of customer-ownership generically in his testimony. With respect to Midwest Energy specifically, I would emphasize management has no incentive to inflate or drive up the costs of serving Midwest Energy customers. They pay us. The Board they elect holds me accountable for providing efficient and reliable service at a competitive cost. While the Commission is the ultimate authority over this rate increase, the Board had to authorize it first. The Board Resolution is included in Section 1 of the Application.

Q: Why does Midwest Energy use the term "patronage capital" for equity?

A: Because, as with other cooperatives, Midwest Energy's customers build their equity ownership through their use of our services.

Q: Why does Midwest Energy target a 20 year rotation of patronage capital?

A: Unlike investors in publicly traded utilities, cooperative customers do not receive dividends. They also do not hold fungible shares of stock that can be traded in a liquid market. Midwest Energy's Board, like that of other Kansas cooperatives and cooperatives across the country, believes customers should at some point get their money back, and have it be replaced by margins earned more recently. That's why we call it capital rotation. Our 20 year capital rotation cycle, with full payment of capital credits to estates, reflects Midwest Energy's need to balance the risks and lower costs of debt against the financial flexibility and higher cost of equity financing for system replacements, improvements and additions.

Q: Does this conclude your testimony?

A: Yes.

STATE OF KANSAS)
) ss.
COUNTY OF ELLIS)

AFFIDAVIT OF EARNEST A. LEHMAN

Earnest A. Lehman, being first duly sworn, deposes and says that he is President and General Manager for Midwest Energy, Inc., and that the statements contained in the direct testimony which he is sponsoring in this Docket were prepared by him and are true and correct to the best of his information, knowledge and belief.

Earnest A. Lehman

Subscribed and sworn to me this 21st day of March, 2006.

Connie L. Grant
Notary Public

My Commission Expires:

10-4-08

NOTARY PUBLIC - State of Kansas
CONNIE L. GRANT
10-4-08